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In The

Supreme Court of the United States

October Term, 1973

No. 73-119

In the Matter of

BECK INDUSTRIES, INC.,

Debtor.

TRUSTEES OF BECK INDUSTRIES, INC.,

Petitioners,

vs.

JACK FELDMAN, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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In The

Supreme Court of the United States

October Term, 1972

No.

In the Matter of

BECK INDUSTRIES, INC.,

Debitor.

TRUSTEES OF BECK INDUSTRIES, INC.,

Petitioners,

vs.

JACK FELDMAN, et al.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit dated April 30, 1973. The judgment of the United States Court of Appeals for the Second Circuit reversed an order of the United States District Court for the Southern District of New York, which order affirmed an order of the Referee in Bankruptcy, restraining respondents from continuing a Maryland state court action.

Opinions Below

The opinion of the Court of Appeals (Appendix, infra, 19a-41a) is unreported as of this date. No opinion was issued by the Court of Appeals in denying a petition for rehearing. The opinion of the District Court (Appendix, infra, 14a-18a) is reported under the title, In the Matter of Beck Industries, Inc., Debtor, 348 F. Supp. 397 (1972). The Referee's decision (Appendix, infra, 1a-13a) is unreported.

Jurisdiction

The judgment of the Court of Appeals was made and entered on April 30, 1973 (Appendix, infra, 47a-49a). On May 31, 1973, the Court of Appeals denied a petition for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Question Presented

The question presented for determination is whether a reorganization court has jurisdiction to restrain a state court action brought against a wholly-owned subsidiary of a Chapter X debtor by former owners of the equity of said subsidiary, which suit seeks in effect to rescind the transaction by which the equity was acquired by the debtor and to recover damages for an alleged breach of the acquisition agreement.

Statutes Involved

11 U.S.C. §511, Bankruptcy Act §111:

> "Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of

this chapter, have exclusive jurisdiction of the debtor and its property, wherever located."

11 U.S.C. §516(4), Bankruptcy Act §116(4):

"Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties in this chapter conferred and imposed upon him and the court. . . .

* * *

(4) in addition to the relief provided by section 29 of this title, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor."

26 U.S.C. §368(a)(1)(A):

"(a) Reorganization. . .

(1) In general. . . .For purposes of parts I and II and this part, the term 'reorganization' means. . .

(A) A statutory merger or consolidation. . . ."

26 U.S.C. §368(a)(2)(D):

"(a) Reorganization. . .

* * *

(2) Special rules relating to paragraph (1). . .

* * *

(D) Statutory merger using stock of controlling corporation.

. . .The acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as 'contolling corporation'), which is in control of the acquiring corporation, to substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction under paragraph (1) (A) if (i) such transaction would have qualified under paragraph (1) (A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction."

17 C.F.R. 230.133, Securities Act of 1933, Rule 133, is set forth in the appendix (Appendix, infra, 42a-46a).

Statement of the Case

Beck Industries, Inc. (hereinafter referred to as "Beck"), is a conglomerate which on May 27, 1971, filed a petition for reorganization under Chapter X of the Bankruptcy Act (the "Act") 11 U.S.C. §501 et seq. The petition was approved on the same date.

Beck was incorporated in 1932 under the name of A.S. Beck Shoe Corporation. It changed its name to Beck Industries, Inc., on October 29, 1968. From 1932 to mid-1968, Beck was engaged primarily in the manufacture and sale of women's and men's shoes. Commencing in June, 1968, Beck embarked on a program of expansion. As a result, Beck's most valuable assets consist of its interest in various wholly-owned operating subsidiary corporations. One of said subsidiary corporations is Webster Clothes, Inc. (hereinafter "New-Webster"), a Delaware corporation which is engaged in the retail sale of men's clothes and furnishings.

In early 1969, negotiations were conducted between Beck and the shareholders of Webster Clothes, Inc. (hereinafter "Old-Webster"), a Maryland corporation, which resulted in the acquisition of all the outstanding stock of Old-Webster in exchange for Beck stock. During the course of the negotiations, the stockholders of Old-Webster requested that the transaction be carried out as a tax-free reorganization pursuant to Internal Revenue Code of 1954, §368(a)(1)(A) (hereinafter cited as "Code §"). Such a reorganization is in reality a triangular three-party merger,

which receives tax-free treatment if it conforms to the requirements of a hybrid "Type A" form of reorganization. The hybrid "Type A" merger (Code §368(a)(2)(D)) permits a subsidiary corporation to exchange its parent's stock for shares of a third corporation, said third corporation being acquired in a statutory merger in which said third corporation is merged into the subsidiary.

To accommodate the stockholders of Old-Webster and in furtherance of their desired tax-free reorganization, and for the specific purpose of creating a vehicle to effectuate such merger, Beck formed a new subsidiary, New-Webster (which was then named Beck-Webster, Inc.). Upon its incorporation, New-Webster issued all of its shares of stock to Beck in exchange for 84,388 shares of the latter's common stock. On May 6, 1969, a Plan and Agreement of Reorganization (hereinafter "Plan and Agreement") was entered into by and among Old-Webster, the stockholders of Old-Webster, Beck and New-Webster. The Plan and Agreement provided, in pertinent part, that in order to effectuate a reorganization which would qualify under the Internal Revenue Code, Old-Webster would be merged into New-Webster and that after said merger, the latter would change its name to Webster Clothes, Inc. The merger was to take place pursuant to Articles and Agreement of Merger (hereinafter "Merger Agreement") which was fully set forth as an exhibit to the Plan and Agreement.

Statement of the Case

On or about June 13, 1969, pursuant to the Plan and Agreement, the stockholders of Old-Webster exchanged their stock in Old-Webster for 84,388 shares of Beck's common stock which were then held by New-Webster, and the statutory merger was effected.

The Plan and Agreement also provided that if on December 31, 1971, the "Market Value" (as defined therein) of a share of Beck common stock was less than 150% of its value on May 6, 1969, then "additional shares" of Beck common stock would be delivered to the former stockholders of Old-Webster so that the total value of Beck shares held by the former stockholders of Old-Webster would be equal in value to 150% of the value of such shares on May 6, 1969. Said additional shares were to be delivered on or before the latter of (a) January 15, 1972; (b) ten days after the "Market Value" of the shares is determined; or (c) three days after Beck's application to list such shares has been approved by the American Stock Exchange.[1]

On January 13, 1972, Jack Feldman, et al., respondents herein[2] (hereinafter collectively re-

1. Because of Beck's pending reorganization, no application has been made at this time to list any additional shares on the American Stock Exchange and therefore no approval has been obtained from said Exchange.

2. Jack Feldman, Nancy I. Feldman Gimbel, Abraham Feldman, Lena Feldman, Julius Feldman, Selma Feldman, Helen W. Feldman and Abraham Feldman, Personal Representatives for Louis S. Feldman, deceased, Doris Feldman Hyatt, Leba Ann Feldman Rotker, Florence L. Kobernick, Linda D. Duritz, (Cont'd)

ferred to as the "Feldmans"), who, as the former owners of 65% of the Old-Webster stock, were participating parties in the aforementioned merger, instituted an action in the Circuit Court of Baltimore City, Baltimore, Maryland (hereinafter the "Maryland proceeding") against New-Webster. The Feldmans instituted the action by filing a Bill of Complaint which sought, inter alia, to cancel and rescind the Merger Agreement entered into by Old-Webster, all of the stockholders of Old-Webster, New-Webster and Beck. The complaint alleged that on December 31, 1971, Beck's common stock was bid at 25¢ a share; that under the Plan and Agreement 15,000,000 additional shares of Beck common stock were required to be delivered by January 15, 1972; that by reason of the reorganization proceeding Beck could not issue any such additional shares; that there was a total failure of consideration and that the Plan and Agreement to which Beck was a party should, therefore, be rescinded. Alternatively, the Feldmans claimed money damages up to $2,700,000.

At the time of the filing of the Bill of Complaint, the Feldmans sought and were granted an ex parte order which enjoined New-Webster "and all other persons in active concert and participa-

(Cont'd)

Rose Feldman, Norma Feldman Schrago, Bernice Elain Suser, Stephen A. Suser, Mercantile Safe Deposit & Trust Co., Guardian for Susanne Louise Feldman, Mercantile Safe Deposit & Trust Co. and Abraham Feldman Trustees of Suzanne Louise Feldman, Mercantile Safe Deposit & Trust Co. and Abraham Feldman, Trustees of Nancy Ilene Feldman Gimbel, Mercantile Safe Deposit & Trust Co. and Jack Feldman, Trustees under Will of Edward Feldman.

tion with it," obviously including the Trustees of Beck, from doing any of an enumerated list of acts.

The order approving the petition for reorganization of Beck provides, in pertinent parts, that all persons are enjoined from, inter alia:

> ". . .commencing or continuing any action at law or suit or proceeding in equity against said debtor or said trustees in any court, or from executing or issuing or causing the execution or issuance out of any Court of any writ, process, summons, attachment, subpoena, replevin, execution or other process for the purposes of impounding or taking possession of or interfering with or enforcing a lien upon any property owned by or in the possession of the said debtor or said trustees, and from doing any act or thing whatsoever to interfere with the possession or management by said debtor or said trustees in the discharge of their duties, or to interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over said debtor and said trustees and their respective properties . . . ." (Emphasis added.)

Said order further provided that the Trustees were authorized to "operate the business and manage the property" of Beck and

> "[t]o exercise all the rights of the debtor as the sole stockholder of the debtor's various subsidiary corporations."

Statement of the Case

On January 21, 1972, the Trustees of Beck moved by Order to Show Cause for an order enjoining the Feldmans from (a) taking any further steps or actions in the Maryland proceeding and from (b) in any other manner interfering or continuing to interfere with the possession or management by the Trustees of the estate of Beck. By stipulation filed on January 25, 1972, the Feldmans agreed to vacate the ex parte order issued in the Maryland proceeding and the Trustees agreed to refrain from entering into any unusual transactions with New-Webster.

By a decision dated April 19, 1972, Honorable Asa S. Herzog, Referee in Bankruptcy, granted the Trustees' application and restrained the Feldmans from taking any further action in the Maryland proceeding.

On review of the Referee's order, the United States District Court for the Southern District of New York, affirmed the order staying the Maryland proceeding. On April 30, 1973, the United States Court of Appeals for the Second Circuit reversed the decision of the District Court.

Reasons for Granting the Writ

The United States Court of Appeals for the Second Circuit applied erroneous criteria in determining that a reorganization court lacked jurisdiction to restrain a suit against a wholly-owned subsidiary of a Chapter X debtor, the purpose of which is to rescind the transaction by which the subsidiary was acquired. The question presented is of extreme importance in the administration of Chapter X

proceedings, especially since many debtors are now conglomerates rather than having a traditional single-tiered corporate structure. In addition, the opinion tends to conflict with the principles enunciated by the Court of Appeals for the Third Circuit in In re Pittsburgh Rys. Co., 155 F.2d 477 (3rd Cir. 1946)[3] and in In re Imperial "400" National, Inc., 429 F.2d 671 (3rd Cir. 1970).

In its opinion the Second Circuit stated that pursuant to "11 U.S.C. §511 the Bankruptcy Court in Chapter X proceedings has 'exclusive jurisdiction of the debtor and its property, wherever located'" and that section 116(4) of the Act (11 U.S.C. §516(4)) provides that the Court may "enjoin or stay until final decrec the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor." The Court concluded that the general rule as first enunciated by it in In re Adolf Gobel, Inc., 80 F.2d 849 (2d Cir. 1936), was that §116(4) of the Act does not, except in special circumstances, authorize a reorganization court to enjoin the prosecution of an action against an independent solvent subsidiary of a debtor.

We do not believe that Gobel governs. There, a debtor in a section 77B proceeding sought to restrain an action at law against its wholly-owned and independently operated subsidiary. The latter had previously sold certain tank cars to the General American Tank Car Corporation ("Tank Car") and took a leaseback on those tank cars. Tank

3. Cert. denied sub nom. Philadelphia Co. v. Guggenheim, 329 U.S. 731 (1946).

Car brought an action at law in an Illinois State Court to recover damages claiming a breach of the lease.

The Second Circuit in reversing the action of the District Court in granting a stay, determined that the action was not a proceeding against property of the debtor, and that the only consequence to the debtor might be a reduction of the value of its stock in the subsidiary. In so holding the Second Circuit said (80 F.2d 849 at p. 852):

> "[M]ere financial interests of a bankrupt estate in the outcome of litigation pending in the state courts does not authorize the issuance of an injunction against such prosecution."

Here we are not presented with a situation where an ordinary trade creditor, whose claim arose out of a business transaction with a debtor's subsidiary, has commenced an action at law against the latter to recover damages for an alleged breach of the business transaction. Rather, the Feldmans, as former equity holders of the business of New-Webster have brought a suit in equity to rescind that transaction by which Beck acquired the business and for damages for the alleged breach thereof. The Trustees are not attempting to stay an action at law by an ordinary trade creditor of an independent solvent subsidiary of a debtor as in the Gobel case.

Reasons for Granting the Writ

The Second Circuit found that Gobel governed because (1) the Maryland proceeding was directed solely against New-Webster and not against any property of Beck and (2) New-Webster was not "a mere sham or alter ego of Beck." The Court concluded that it was inappropriate to pierce the corporate veil.

We submit that the Second Circuit erred in declining to restrain the Maryland proceeding. While in form it is directed solely against New-Webster, in substance it is a suit against Beck. Simply stated, it is a situation where the Feldmans sold something to Beck and are endeavoring to get it back. What they sold to Beck is their stock in Old-Webster. If a creditor of a Chapter X debtor was attempting to get back something it sold to Beck prior to the filing of a petition a Court could certainly stay such an attempt. In substance, the Feldmans are doing nothing more than attempting to get back the stock which they sold to the debtor. By bringing their proceeding against New-Webster they are merely masking the attempt in the hope that the substance of the proceeding will give way to the form that it has taken. There is no necessity for the Court to pierce the corporate veil of New-Webster in order to enable it to stay the Maryland proceeding. All the Court need do is look to the substance of the proceeding to determine that it is properly within its power to stay such a proceeding under Section 116(4) of the Act. 11 U.S.C. §516(4).

Reasons for Granting the Writ

This is not a case seeking to consolidate in one reorganization proceeding a parent debtor with a wholly-owned solvent subsidiary. Beck is a mini-conglomerate with inherent problems that are vastly different from those that once faced single-tiered entities. As such, the jurisdictional authority that Congress vested in the Bankruptcy Court must be adapted to meet its present needs; specifically, the needs of conglomerates. Other courts have already dealt with this issue and have arrived at a statutory sound and workable solution, all within the framework of the Bankruptcy Act.

The distinct problems that face the conglomerates of today have been recognized by the Court of Appeals for the Third Circuit, where it was faced in two instances with the necessity of determining the jurisdiction of the reorganization court in administering complex debtor estates. It is submitted that the problems facing the Third Circuit in the matters hereinafter discussed are more analogous to the case at bar than the Gobel case.

In In re Pittsburgh Rys. Co., 155 F.2d 477 (3rd Cir. (1946),[4] the Third Circuit dealt with a proceeding involving the reorganization of a transportation system consisting of a debtor railroad and its solvent underlying subsidiary companies. The Court realized the scarcity of judicial precedent for its decision, but concluded that the facts of the case called for the treatment of the re-

4. Cert. denied sub nom. Philadelphia Co. v. Guggenheim, 329 U.S. 731 (1946).

lationship between the debtor and the underlying subsidiary companies as one entity for problems of reorganization.

In In re Imperial "400" National, Inc., 429 F.2d 671 (3rd Cir. 1970), a corporation's ("Imperial"), principal business consisted of constructing, furnishing, as well as operating a chain of more than 100 motels throughout the United States. Ninety-seven of these motels were owned by partnerships formed pursuant to partnership agreements between Imperial and individual co-partners. In each of these motels Imperial held at least a 50% interest. In June of 1965, an order was entered by a New Jersey District Court approving the Chapter X petition filed by Imperial. The order restrained all actions against Imperial as well as restraining the issuance of any process or conduct of any proceeding which would interfere with the Trustee's possession of Imperial's property. Thereafter, the Kuballs, co-partners with Imperial in one of the motels located in Michigan, filed a petition in bankruptcy, on behalf of their Michigan motel partnership, in the District Court for the Western District of Michigan.

The Kuballs' petition was filed without the knowledge or permission of the New Jersey Bankruptcy Court. Upon learning of the Michigan bankruptcy proceedings, the Trustee in reorganization of Imperial sought and was eventually granted an order restraining and enjoining the partnership bankruptcy proceedings instituted in Michigan. Thereafter, an order was issued by the New Jersey Bankruptcy Court transferring the Michigan bank-

ruptcy proceedings to the New Jersey Bankruptcy Court. The Kuballs appealed from said order to the Court of Appeals for the Third Circuit contending, inter alia, that the New Jersey reorganization court did not have jurisdiction to enjoin the Michigan bankruptcy proceedings since Imperial had no property interest in the assets of the Michigan motel partnership, but was merely a partner therein.

The Third Circuit while recognizing the limited power of a reorganization court to enjoin suits against solvent subsidiaries of a debtor stated that:

> "In order to effectuate the purpose of Chapter X proceedings — 'to render the authority and control of the reorganization tribunal paramount and all-embracing to the extent required to achieve the ends contemplated by Chapter X; and to exclude any interference by the acts of others or by proceedings in other courts where such activities or proceedings tend to hinder the progress of reorganization' — this Court has indicated that traditional concepts of property, title and separate entities may have to give way." Id. at p. 677.

The Court also said:

> "The definition of property for bankruptcy purposes and the authority of a reorganization court over a debtor's property have been interpreted broadly." Id. at p. 676.

* * *

> "Bankruptcy proceedings are inherently proceedings in equity. Reorganization proceedings under the Bankruptcy Act are 'special' proceedings which seek only to bring about a reorganization. The tendency of judicial interpretation of the Act has been in the direction of progressive liberalization in respect of the operation of the bankruptcy power so as to meet the challenge of present day economics and business conditions." (Emphasis added.) Id. at p. 677.

The Third Circuit in Imperial "400" recognized that Congress did not give the Bankruptcy Court exclusive jurisdiction over any and all controversies which might in some way affect the debtor's estate. But the Court also recognized, which the Second Circuit failed to do, that the existence of complex business relationships require the ability on the part of the reorganization court to

> "enjoin the prosecution of any suit which would take from it the decision of any question which it has the duty to decide in connection with the reorganization, or which would hamper it in any way in exercising the power imposed upon it by Chapter X." (Emphasis added.) Id. at p. 677.

Accord, In re Central Railroad Company of New Jersey, 469 F.2d 857 (3rd Cir. 1972).

Reasons for Granting the Writ

The Court of Appeals for the Fifth Circuit recognizing the rationale of Imperial "400" quoted with approval some of its language in In re Westec Corporation, 460 F.2d 1139, 1142-43 (5th Cir. 1972). Specifically, it quoted the language dealing with the traditional concepts of property giving way to those which aid rather than hinder achieving the ends contemplated by Chapter X.

These decisions of the Third and Fifth Circuits have recognized what the Second Circuit has apparently overlooked, namely, that the Court's purpose under Chapter X of the Act is to carry out an efficient and equitable adjustment, making the debtor sound, while respecting to the greatest extent possible, the rights of creditors. As a result, the concepts of property and title must be treated flexibly to achieve that purpose.

A stay of the Maryland proceeding will permit the efficient administration of the estate while in no way prejudicing those creditors who dealt with New-Webster as an independent and separate entity. The Feldmans are not such creditors. They are former equity holders.

The Second Circuit, after analyzing the basic transaction upon which the alleged obligation of New-Webster was based, concluded that the Feldmans bargained for and received certain guarantees as the quid pro quo for the benefits that were received by Beck. The Court also concluded that since the creation of New-Webster and the resulting tripartite form of merger which was used to acquire Old-Webster was the result of a

business transaction which benefited both Beck and the Feldmans, there was no reason to uphold Referee Herzog's order.

> "Were we to accept the factual premises underlying the decisions of the Referee and the District Court, we would have no difficulty agreeing with their conclusion.... On the contrary...[New-Webster] was formed for the mutual benefit of the parties..." (Emphasis as in original.) (Appendix infra, 34a-35a).

It is respectfully submitted that the Court of Appeals erred in concluding that Beck stood to gain "substantial benefits from the organization of [New-Webster]" and the resulting tripartite form of merger. The plain fact is that if Beck had directly acquired the shares of stock of Old-Webster, in exchange for Beck's shares, Beck would have received exactly the same benefits while retaining its insulation from the obligations and debts of Old-Webster. Old-Webster would then have been a wholly-owned subsidiary of Beck and Beck would have been able to treat the acquisition, for accounting purposes, as a "pooling of interests" rather than as a purchase. See, ARB No. 48, Par.12 (Jan. 1957). The direct acquisition of the Feldmans' stock in the manner outlined above would not have necessitated Beck's obtaining approval from its stockholders as is alluded to by the Court of Appeals (Appendix, infra, 39a).

Whereas the above-outlined transaction would result in the same benefits to Beck as the tripartite transaction did, the disadvantages to the Feldmans are obvious. They would have been prohibited for a period of up to two and a half years from selling any of their newly acquired Beck shares without registration under former Rule 133 of the Securities Act of 1933 (17 C.F.R. §230.133). Such a transaction would have risked the tax-free benefits gained by the Feldmans as a result of the tripartite transaction. It is also possible that the Internal Revenue Service would have disqualified the entire transaction from its tax-free treatment if it found any "boot" was to be given to the Feldmans in such a transaction. Such risks did not exist in the tripartite transaction, which clearly was for the benefit of the Feldmans. Therefore, it can be seen that the sole reason for the organization of New-Webster and the resulting tripartite form of merger was to benefit the Feldmans.

New-Webster never had an independent existence prior to the merger. It has no assets except those that were funnelled into it by Beck solely for the purpose of effecting the merger. Prior to the merger, New-Webster never had any of its own business; it never had any creditors; it never had any employees; and it never had any contract whatsoever, with anyone outside the scope of the merger transaction. All of the directors of New-Webster were officers of Beck and these same directors were the people who represented Beck throughout the merger negotiations and transactions. The Plan and Agreement was signed on behalf of both Beck and New-Webster by the same person.

The Feldmans, as stockholders of Old-Webster, had full and complete knowledge of the fact that they were dealing directly with Beck, and that New-Webster was created entirely for their benefit. To say now, as the Second Circuit did, that New-Webster should be treated as a separate and distinct entity, for the purpose of undoing and rescinding the merger transaction, would permit form to rule over substance.

The Second Circuit also failed to consider the conflict which will exist if the stay of the Maryland proceeding is not continued. As was previously pointed out, the order approving the petition for the reorganization of Beck directs the Trustees to "operate the business and manage the property" of Beck and

> "[t]o exercise all the rights of the debtor as the sole stockholder of the debtor's various subsidiary corporations."

Said provisions are in direct conflict with the provisions of the ex parte order granted to the Feldmans in the Maryland proceeding. Said order enjoined New-Webster "and all other persons in active concert and participation with it," from doing any of an enumerated list of acts, including: making payments to Beck or its affiliates on account of any debt or account payable; loaning or advancing any funds to Beck or its affiliates; agreeing to change the terms of any agreement under which Beck furnishes management or other services to New-Webster; mortgaging or encumbering the assets of New-Webster, except in the

ordinary course of business; discharging or incurring any liens or encumbrances or paying any obligations or liabilities except those incurred in the ordinary course of business; making any changes in the authorized or issued shares of New-Webster; amending the Articles of Incorporation or the By-Laws of New-Webster.

The Trustees cannot effectively operate New-Webster as directed by the District Court in the face of the ex parte order. If the Maryland Court reinstates that order, there will be a clear conflict between the two, which the Second Circuit has failed to perceive.

We note that subsequent to the tripartite merger Beck conferred substantial tax benefits upon New-Webster by reason of the tax shelter it has provided as a result of the consolidated Federal Income tax returns that have been filed for the 1971 and 1972 fiscal years.

Although the Feldmans opposed the application of the Trustees which sought to require New-Webster to enter into an agreement with Beck whereby it would agree to pay to Beck its tax savings as a result of its inclusion in the consolidated tax return filed for the year ending January 29, 1972, that application was recently granted by Referee Herzog. The Court stated in its opinion granting the aforesaid application, that no payments would be made to Beck until "the further order of this Court."

As a defense to that application, the Feldmans stated in their answer that they had a claim against New-Webster and that it was "anticipated" the Trustees would demand close to $650,000; that said amount represented the alleged tax savings to be paid to Beck and that any such payment "would render the net worth of * * * [New-Webster] insufficient to meet the claims of * * * [the Feldmans] and other creditors."

The Feldmans' position was in effect that all tax savings should stay with New-Webster and that at the same time they should be permitted to bring a suit against New-Webster to recover their claim or to recover the stock of New-Webster. We submit that such a position is completely inequitable and if the Maryland Court issues another ex parte order consistent with its prior order the conflict between such an order and the order authorizing the Trustees to take control of the subsidiaries' shares will become even more apparent.

The hesitancy of Courts to stay suits against a debtor's subsidiary results from a desire on their part to insure that creditors of a solvent subsidiary, which extended credit to such subsidiary in the belief that they were dealing with that specific corporate entity, should not become involved in the affairs of another entity (a parent corporation) to which they did not extend credit or with which they did not contract. In re Adolf Gobel, Inc., supra. The Second Circuit has simply failed to recognize that such a situation is not present in this case.

We submit that a stay order would give the Trustees an opportunity to formulate a plan of reorganization and to discharge the statutory duties imposed upon them by the Act. It may well be that the Trustees can propose a plan which will be fair and equitable and will satisfy the Feldman's claim as well as the claims of other equity claimants while preserving the interest in the assets of the conglomerate debtor for the benefit of the other creditors of the estate herein. The Trustees would be unable to prepare such a plan if they were forced to litigate the claims of former holders of equity interest in the debtor's conglomerate holdings in various courts throughout the country. On this basis alone, the order of the District Court should have been affirmed so that the Trustees would have a reasonable opportunity to prepare and present such a plan. The Feldmans could hardly be prejudiced under these circumstances. Even if they had received the additional stock, they could not possibly have done anything with it as trading had been suspended.

The task of the Trustees is to hold the debtor together as a unit, to keep it operating, to dispose of the deadwood, to conduct the thorough investigation imposed by statute and eventually to formulate a plan of reorganization or to report why a plan cannot be proposed. This is a large and complicated case. The problems are myriad and complex. The Bankruptcy Court should be permitted, in this particular case, to invoke its equitable powers so that substance will not give way to form and so that technical considerations will not prevent substantial justice from being done.

Conclusion

For all of the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

Jesse Climenko
Counsel for Petitioners

Martin I. Shelton
Lonn A. Trost
Of Counsel

APPENDIX

Referee's Decision

(Dated April 19, 1972)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- -

In the Matter

-of- No. 71-B-523

BECK INDUSTRIES, INC.,

Debtor.

- -

APPEARANCES:

SHEA, GOULD, CLIMENKO & KRAMER, ESQS.
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Attorneys for Chase Manhattan Bank, N.A.
By: SAMUEL R. BALLIN, ESQ., Counsel

ASA S. HERZOG, Referee:

The Chapter X trustees move by application and order to show cause for an order enjoining the respondents from further proceeding with a certain action pending in the Circuit Court of Baltimore City, Maryland, in which respondents are plaintiffs and Webster Clothes, Inc. is defendant.

Webster Clothes, Inc. is a wholly-owned subsidiary of the debtor. Opposition to this motion is grounded upon the argument that the Chapter X court lacks jurisdiction to restrain suits against an independent, solvent subsidiary. Since this is, indeed, the general rule absent unusual circumstances, it is necessary to look beneath the surface to the underlying facts which led up to the law suit in question.

In the early part of 1969, the debtor entered into negotiations with the stockholders of Webster Clothes, Inc., a Maryland corporation (Webster, Md.), for the purpose of acquiring the stock of that company. In order for the Webster (Md.) stockholders to enjoy certain benefits of a tax-free reorganization pursuant to § 368(a)(1)(A) of

the Internal Revenue Code,[1] a Delaware corporation, Beck Webster, Inc., was formed on April 25, 1969. On May 6, 1969, an agreement entitled "Plan and Agreement of Reorganization" was entered into among the debtor, Webster (Md.) and its stockholders, and the newly formed corporation, Beck Webster, Inc., which provided inter alia, for the merger of Webster (Md.) into the new corporation, Beck Webster, Inc. On the same day, May 6, 1969, and in accordance with the provisions of the "Plan and Agreement of Reorganization," a merger agreement was entered into between Webster (Md.) and Beck Webster, Inc. Shortly thereafter the name of Beck Webster, Inc. was changed to Webster Clothes, Inc. [Webster (Del.)].

Further carrying out the agreements between the parties, Webster (Del.) issued all of its capital stock to the debtor (thereby becoming its wholly-owned subsidiary), and on June 10, 1969, the debtor transferred to Webster (Del.) 84,388 shares of its stock. Three days later and on June 13, 1969, the stockholders of Webster (Md.) delivered to Webster (Del.) their shares of Webster (Md.) stock in return for the aforesaid 84,388 shares of the debtor's stock.

The agreement between the parties provided that if on December 31, 1971, the market value of the said 84,388 shares were less than 150% of the value thereof on May 6, 1969, then and in

1. By structuring the transaction as a tax-free reorganization pursuant to I.R.C. § 368(a)(1)(a), the Webster (Md.) stockholders hoped to avoid realizing any taxable income and moreover they could sell the newly-acquired Beck stock without a lengthy waiting period.

that event there would be issued to said stockholders additional shares of debtor's stock so as to bring the value of their holdings up to the required 150%. Several methods of determining the date of such additional transfer were set forth in the agreement, the details of which are not important at this juncture.

On May 27, 1971, the debtor's petition for reorganization pursuant to Chapter X of the Bankruptcy Act was approved by this court and the usual order was made and entered restraining all persons from interfering with the exclusive jurisdiction of this court over the debtor and its property. Of course, on December 31, 1971, the 84,388 shares were not worth 150% of their value on May 6, 1969, and the time fixed for delivery of the additional shares arrived and the stock was not forthcoming.

On January 13, 1972, the respondents, who had been the owners of approximately 65% of the Webster (Md.) stock, instituted the Maryland action against Webster (Del.) to rescind the merger agreement on the ground of failure of consideration since obviously in view of these reorganization proceedings Webster (Del.) could not deliver the requisite additional shares of debtor's stock.

Moving ex parte, the respondents sought and were granted an order in the Maryland court restraining the trustees herein from performing certain enumerated acts respecting Webster (Del.). Thereafter and on January 21, 1972, United States District Judge Cannella signed the order requiring the respondents to show cause before the under-

signed why they should not be enjoined from proceeding with the Maryland action. The respondents were ordered to, and I understand they did, take the necessary steps to vacate the ex parte order issued out of the Maryland court.

I doubt that the respondents would gainsay the fact that the Chapter X petition of the debtor is the motivation for the Maryland suit. They parted with their stock ownership of a successful venture, Webster (Md.), in return for some 84,388 shares of the debtor and the promise of additional shares if within the time specified the value of debtor's stock had not increased to 150% of its value on May 6, 1969. With the filing of the petition in Chapter X, the value of the stock became problematical; indeed, it may well be worthless. An action against the debtor to rescind the May 6, 1969 agreement would most certainly violate the restraining order issued out of this court. But the manner in which the transaction was worked out, a separate corporate entity was interposed between the debtor and the Webster (Md.) stockholders by having the 84,388 shares of debtor's stock transferred to the newly created subsidiary and thence to the respondents who transferred their shares to the subsidiary. Thus, technically, a successful rescission suit against the subsidiary would effectively result in regaining possession of the assets transferred out of the Webster (Md.) corporation - and, hopefully, without violating the restraining order issued out of the Chapter X court.

Decision

The question, then, is whether the corporate entity of Webster (Del.) is so sacrosanct that it must be permitted to stand as a barrier between the Chapter X court and the respondents, who, shedding legal parlance, are seeking to regain property which actually represents a vital asset of the debtor?

As noted at the outset, the obstacle, which would seem to stand in the way of jurisdiction is the line of cases holding that Section 116(4) [2] does not authorize the Chapter X court to enjoin prosecution of a suit against a wholly-independent subsidiary by a creditor thereof. But that is only the general rule and, as the Third Circuit Court of Appeals remarked, the jurisdiction question must depend on each particular case. [3]

The cases relied upon by the respondents do no more than pronounce the general rule:

Greenbaum v. Lehrenkrauss Corporation [4] involved an equity receivership. The receivers of Lehrenkrauss Corporation sought to enjoin the New York Superintendent of Insurance from pursuing his action for liquidation and dissolution of the Lehrenkrauss Title Company, on the basis of the ownership by Lehrenkrauss Corporation of "nearly all of the shares" of stock of the Title Company.

2. "(4) in addition to the relief provided by Section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor."

3. In re South Jersey Land Corp., 361 F.2d 610 (3d Cir. 1966).

4. 73 F.2d 285 (2d Cir. 1934).

Decision

The court noted that, "The only ground upon which the order could be supported would be a finding that the Title Company and the receivership defendant are in substance one corporation so that the fiction of separate corporate entities may be disregarded." In that case it appeared, to the contrary, that the Title Company was a distinct corporation, having its own assets, creditors and obligations under the New York Insurance Laws and there simply was nothing shown which justified "the enjoining of one of the corporations on a bill for receivership filed against the other."[5]

In re Madison Mortgage Corporation[6] involved very much the same facts. Madison Mortgage, the corporation in reorganization owned the entire capital stock of Equitable Mortgage, a company whose affairs were in the hands of the Superintendent of Insurance under the guidance of the New York Supreme Court. The plan of reorganization envisioned sale of the Equitable stock to a purchasing group, a plan which was in danger of being wrecked when the Superintendent of Insurance moved in the New York Supreme Court for leave to liquidate and wind up the business of Equitable. The trustee in reorganization was denied injunctive relief by the reorganization court on the ground that Equitable was not in reorganization in the bankruptcy court nor even amenable to reorganization under the bankruptcy laws. The necessity for liquidation of Equitable, said Judge

5. 73 F.2d at p. 286.

6. 22 F.Supp. 99 (S.D.N.Y. 1937).

Patterson, "is solely the concern of the New York Supreme Court. The trustee of the parent may make his protests there." The problem in Madison Mortgage was entirely unrelated to that presented in the case sub judice. The rule of Madison Mortgage can be simply stated thus: The reorganization court will not interfere with State court proceedings for the liquidation of a subsidiary insurance company which is not amenable to the bankruptcy laws.

In re Pittsburgh Rys. Co.[7] is of no assistance, merely holding that the reorganization court (in a railroad reorganization case) did not have the jurisdiction over the various properties leased to the debtor by underlying companies, nor power to determine substantive rights of creditors and stockholders of said underlying companies, notwithstanding that convenience would require continued administration of the debtor as a unit. Quoting from a previous decision in the same, case,[8] the court said: "The underlying companies' relation to the Pittsburgh Railways Company is that of creditor and debtor and no principle of equity justifies ignoring that relation when, so to do, might adversely affect the claims of other creditors."

In re Adolph Gobel, Inc.[9] is more in point,

7. 60 F.Supp. 600 (W.D.Pa. 1945).

8. In re Reorganization of Pittsburgh Rys. Co., 111 F.2d 932.

9. 80 F.2d 849 (2d Cir. 1936).

involving as it did, the power of the reorganization court (under former § 77B) to restrain suit against a subsidiary. There, the debtor, Gobel, owned the stock of Decker, an independently managed corporation. The subsidiary, Decker, entered into an agreement with General American Tank Corporation involving the lease of certain refrigeration and tank cars. General American brought suit against Decker in the Illinois courts for damages for breach of the car lease. Reversing the District Court which had enjoined the action, the Court of Appeals noted that the suit was not against the debtor nor was it a judicial proceeding to enforce a lien upon its estate. The assets of Decker were involved, and not the Decker stock which formed part of the debtor's estate. The lesson of this case is that the reorganization court will not enjoin a creditor of a solvent, wholly-independent corporation from prosecuting an action at law in the State court "merely because its common stock is held by the debtor in reorganization proceedings." "Mere financial interest in the outcome of the litigation," the court said, "does not authorize the issuance of an injunction against such prosecution." (Emphasis added.)

There are still other cases which stand for the same proposition,[10] but none involved unusual circumstances which would justify an exception to the general rule they express. Nor do any of the authorities even remotely related to the question

10. Callaway v. Benson, 336 U.S. 136 (1949) [the bankruptcy court does not have jurisdiction over all controversies "that in some way affect the debtor's estate."]. In re Copper Canyon Mining Company, 156 F.Supp. 535 (D.C. Del. 1957); In re Panitz, 270 F.Supp. 448 (D.C.Md. 1967).

suggest that under no condition could there be a departure from the general rule. As a matter of fact, Lehrenkrauss[11] suggests otherwise when it states: "The only ground upon which the order could be supported would be a finding that the title company and the receivership company are in substance one corporation so that the fiction of separate corporate entities may be disregarded." (Emphasis added.)

In re South Jersey Land Corp.,[12] goes considerably further in opening the door to possible exceptions to the general rule, remarking that the jurisdiction question must depend on each particular case. Although the court there reversed the restraining order, it accomplished the same ends by upholding an order directing reconveyance of the property in question. What is of especial interest, however, is note 6 to the opinion in which the court pointed out that if it could not resolve the problem as it did (i.e., affirming the order directing reconveyance), "the equities of the instant appeal might compel us to a different conclusion." (Emphasis added.)

In other words, the court did not have to resort to the "equities" to reach a conclusion which in fact served the same end by preserving the property in question. What is compelling about this case is that it does show the way of escape from the general rule, i.e., when the

11. 73 F.2d 285, supra, notes 6, 7.

12. 361 F.2d 610 (3d Cir. 1966), supra.

equity requires the "veil" to be "pierced" or the "cloak" to be "stripped off." [13]

In the instant situation I conclude that the equities demand departure from the general rule. The subsidiary corporation, Webster (Del.), is an independent entity by virtue of the sheerest fiction. It was a mere adjunct of instrumentality of the parent, Beck. It was, in fact, an "instrumentality" of all the parties including the respondents in effecting the so-called merger which transferred the assets of Webster (Md.). The subsidiary was as much the pawn of the debtor as it was of the respondent.

The plain and unadulterated essence of the overall transaction between the respondents and the debtor was the debtor's acquisition of Webster (Md.) by the respondents exchanging their shares of the Webster (Md.) stock for shares of the debtor's stock. Webster (Md.) was merely the conduit through which transfer was accomplished.

The devious route by which this basic purpose was accomplished: — the formation of Beck-Webster, Inc., the transfer of assets of Webster (Md.) to the newly formed corporation, the change of name to Webster Clothes [Webster (Del.)], the issuance of debtor's shares to Webster (Del.) in exchange for Webster's (Del.) authorized capital stock, and finally, transfer of those same shares of the debtor to the respondents — all of this legal rigamarole

13. 361 F.2d 610, notes 5, 6, supra.

was merely to give certain advantages to the respondents, as hereinabove noted.[14]

But while the legal entity of Webster (Del.) might be recognized by others in authority for tax purposes or for trading purposes, I cannot allow the legal fiction of its separate existence to bar injunctive relief from a suit against the subsidiary which in truth and fact is the clearest attempt to effect rescission of a contract with the debtor. The concept of disregarding the corporate veil of a subsidiary for specific transactions and not for others is not entirely new.[15] The prosecution of the Maryland suit so directly affects the property of the debtor that protection of the estate requires a stay.[16] The bankruptcy court has not hesitated to invoke its equitable powers to the end that substance will not give way to form and that technical consideration will not prevent substantial justice from being done.[17] If to protect the debtor's estate I must pierce the corporate veil, then pierce it I do.

The motion to restrain further proceedings by respondents in the Maryland action will be granted. I understand that the ex parte stay issued by the

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14. Supra, note (1).

15. See Latty, "Subsidiaries and Affiliated Corporations" 1936, Chapter III, § 9, pp. 42 et seq.; In re Security Product Company, 310 F.Supp. 110 (E.D.Mo. 1969) at p. 117.

16. Cf. In re Federal Biscuit Company, 203 Fed. 37 (2d Cir. 1913); In re Collier, 4 F.Supp. 700 (S.D.N.Y. 1933).

17. Pepper v. Litton, 308 U.S. 295 (1959).

Maryland court has been vacated, but if such is not the fact, the respondents and their counsel will be directed to forthwith take the necessary steps to secure vacatur thereof.

Dated: New York, New York
April 19, 1972

s/ Asa S. Herzog
Referee in Bankruptcy

Opinion of the District Court

(Filed September 27, 1972)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- -

In the Matter

of 71 B. 523

BECK INDUSTRIES, INC.,

Debtor.

- -

Memorandum

Appearances:

Shea, Gould, Clemenko & Kramer, by Martin T. Shelton and Herman Bursky, for the trustees of the debtor Beck Industries.

Winer, Neuburger & Sive by David Sive, and Gordon, Feinblatt & Rothman by Donald Rothman for the respondents.

Milbank, Tweed, Hadley & McCloy by Samuel Ballin for the Chase Manhattan Bank, N.A.

Maurice L. Held, appearing for the Securities and Exchange Commission.

CANNELLA, J.

The referee's order enjoining the respondents from proceeding with an action pending in Maryland, in which the respondents are plaintiffs and Webster Clothes, Inc., a wholly-owned subsidiary of the debtor is defendant is affirmed.

In 1969 the debtor entered into negotiations with the stockholders of Webster Clothes, Inc. [hereinafter Webster (Md.)] for the purpose of acquiring the stock of that company. In order for these stockholders to secure the benefits of a tax free reorganization, a Delaware corporation, Beck Webster, Inc., was formed on April 25, 1969. On May 6, 1969, a merger agreement was executed between Webster (Md.) and Beck Webster, Inc. Subsequently, the name of Beck Webster, Inc. was changed to Webster Clothes, Inc. [hereinafter Webster (Del.)]. Pursuant to further agreements between the parties, Webster (Del.) issued all its capital stock to the debtor thereby becoming its wholly owned subsidiary and the debtor transferred to Webster (Del.) 84,388 shares of its stock. The stockholders of Webster (Md.) then delivered to Webster (Del.) their shares of stock in exchange for the 84,388 shares of the debtor's stock. The parties further agreed that if on December 31, 1971, the market value of the 84,388 shares were less than 150% of their value on May 6, 1969, the stockholders would receive additional shares of the debtor's stock so as to bring the value of their holdings up to the required 150%.

On May 27, 1971, the debtor's petition for reorganization pursuant to Chapter X of the Bankruptcy Act was approved and an order was entered which restrained any interference with the Bankruptcy Court's exclusive jurisdiction over the debtor and its property. In view of the bankruptcy proceedings, the 84,388 shares were not worth 150% of their previous value and additional shares of the debtor's stock were not delivered. On January 13, 1972, the respondents, owners of approximately 65% of the Webster (Md.) stock instituted the Maryland action against Webster (Del.) to rescind the merger agreement on the ground of failure of consideration. On January 21, 1972, the respondents were ordered to show cause before the referee in bankruptcy why they should not be enjoined from proceeding with the Maryland action.

Although the Maryland action was instituted against the debtor's wholly owned subsidiary which ordinarily is not within the jurisdiction of the Chapter X court, the referee concluded that the equities of the instant case demanded a departure from the general rule. He stated:

> The subsidiary corporation, Webster (Del.), is an independent entity by virtue of the sheerest fiction. It was a mere adjunct or instrumentality of the parent, Beck. It was, in fact, an "instrumentality" of all the parties including the respondents in effecting the so-called merger which transferred the assets of Webster (Md.). The subsidiary was as much a pawn of the debtor as it was of the respondent.

The respondents (petitioners herein) urge that the referee's action in piercing the corporate veil was erroneous. Furthermore, they contend, inter alia, that the referee overlooked certain tax and accounting advantages in the debtor's favor and an independent covenant of the subsidiary to pay full consideration. The court finds that the findings made by the referee are amply supported by the record and the applicable law and therefore affirms the order staying the Maryland action.

Generally, the Chapter X court lacks the power to stay proceedings instituted against the debtor's solvent and wholly-owned subsidiary except in circumstances where the parent and the subsidiary are so completely "one" such that the corporate veil may be pierced. 6 Collier on Bankruptcy §3.11 at 500. See also Callaway v. Benton, 336 U.S. 132 (1949). Although the respondents have cited many cases where courts have refused to pierce the corporate veil, the ultimate decision in each case rests upon the particular facts of each case. See In re South Jersey Land Corporation, 361 F.2d 610 (3rd Cir. 1966). In reviewing the transactions surrounding the organization of the debtor's subsidiary, Webster (Del.), the court is persuaded that the general rule is inapplicable.

It is well settled that courts will not permit themselves to be blinded or deceived by mere forms of law but will deal with the substance and realities of the transactions involved as the equities of the case may require. See e.g., Anderson v. Abbott, 321 U.S. 342 (1944); Pepper v. Litton, 308 U.S. 295 (1939). The essential character of the

agreements between the parties was an exchange of the respondents' stock of Webster (Md.) for the stock of the debtor. The creation of the subsidiary was merely the "instrumentality" or the conduit through which the tax free nature of the transaction was accomplished. The debtor's receipt of certain minor benefits from the exchange and the existence of an independent covenant from the subsidiary does not serve to alter the fundamental character of the transaction.

In view of these considerations, the court is in accord with the referee's ruling that the prosecution of the Maryland action so directly affects the property of the debtor that the protection of the estate requires a stay. Cf. In re Federal Biscuit Company, 203 F. 37 (2d Cir. 1913); In re Collier, 4F.Supp. 700 (S.D.N.Y. 1933). See also In re Beck Industries, 338 F.Supp. 1369 (S.D.N.Y. 1972). Accordingly, the court concludes that the corporate veil should be pierced for the specific transactions involved herein.

So ordered.

Dated: New York, N.Y.
September 26, 1972

s/ John M. Cannella
U.S.D.J.

Opinion of the Court of Appeals

(Decided April 30, 1973)

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 582—September Term, 1972.

(Argued March 20, 1973 Decided April 30, 1973.)

Docket No. 72-2277

In the Matter of

BECK INDUSTRIES, INC., in Proceedings for the Reorganization of a Corporation

Debtor.

JACK FELDMAN, et al.,

Appellants,

-against-

TRUSTEES OF BECK INDUSTRIES, INC.,

Appellees.

Before:

SMITH, FEINBERG and MANSFIED,

Circuit Judges.

Appeal from an order of the United States District Court for the Southern District of New York, John M. Cannella, Judge, affirming an order of the Referee in Bankruptcy, Asa S. Herzog, restraining respondents from continuing a Maryland state court action directed at a wholly-owned subsidiary of the debtor in Chapter X proceedings.

Reversed.

DONALD N. ROTHMAN, Esq., Baltimore, Md. (Robert E. Sharkey, Esq., Gordon, Feinblatt, Rothman, Hoffberger & Hollander, Ober, Grimes & Schriver, Baltimore Md., Winer, Neuburger & Sive, New York, N.Y., of counsel), for Appellants.

MILTON S. GOULD, Esq., New York, N.Y. (Martin I. Shelton, Esq., Herman A. Bursky, Esq., Shea Gould Climenko & Kramer, New York, N.Y., of counsel), for Appellees.

MANSFIELD, Circuit Judge:

The issue on this appeal is whether the Bankruptcy Court had jurisdiction under 11 U.S.C. §§511[1] and 516(4)[2] to restrain Maryland state court proceedings against a wholly-owned subsidiary of the debtor in Chapter X proceedings, Beck Industries, Inc. (hereinafter "Beck"). The subsidiary, Webster Clothes, Inc. (hereinafter "Subsidiary"), had been newly created by Beck for the purpose of entering into a corporate acquisition but subsequent to the acquisition the Subsidiary also was a self-sustaining, viable, autonomous entity engaged in the conduct of its own business, which was separate and distinct from that of Beck. Judge John M. Cannella affirmed the order of Referee Asa Herzog who, by restraining the Maryland court proceedings, in effect found that the assets of Subsidiary constituted "property" of Beck within the meaning of the Bankruptcy Act and thus that the Bankruptcy Court had jurisdiction. The decision was based on the premise that Subsidiary was a mere adjunct or instrumentality of the

1. Title 11, §511 of the Bankruptcy Act provides:

"Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located."

2. Section 516(4) of Title 11 provides:

"Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties in this chapter conferred and imposed upon him and the court—

* * *

"(4) in addition to the relief provided by section 29 of this title, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor."

debtor, permitting the court to disregard its separate corporate existence and pierce the corporate veil. For reasons stated below, we find that the Bankruptcy Court was without jurisdiction to restrain the Maryland court proceedings and we therefore reverse the restraining order.

THE FACTS

The record, which consists of various affidavits and documentary exhibits, reveals the following:[3] In early 1969, negotiations were conducted between Beck, which was a conglomerate, Webster Clothes, Inc. (hereinafter "Webster-Md."), which was a Maryland corporation, and the latter's stockholders regarding the acquisition by Beck of Webster-Md., a long-established, closely-held, going corporate concern engaged in the manufacture and the sale of men's clothing. The form of the transaction was to be a triangular three-party merger, which would conform to the requirements for a hybrid "Type A" form of tax-free reorganization as prescribed by the Internal Revenue Code, 26

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3. Since all of the evidence is documentary we are in as good a position as the district court to appraise and evaluate it. Orvis v. Higgins, 180 F.2d 537, 539 (2d Cir.), cert. denied, 340 U.S. 810 (1950); Norment v. Stilwell, 135 F.2d 132 (2d Cir.), cert. denied, 320 U.S. 763 (1943); 5A J. Moore, Federal Practice Par. 52.04 (2d ed. 1971).

U.S.C. §§368(a)(1)(A) and 368(a)(2)(D).[4] The hybrid "Type A" merger permits a subsidiary to exchange its parent's stock for shares of a third corporation being acquired in a statutory merger in which the third corporation is merged into the subsidiary. Such a transaction qualifies as a tax-free "A" reorganization if: (1) none of the subsidiary's stock is used, and (2) the exchange would have been an "A" type reorganization if the acquired corporation had merged directly into the parent. Here Webster-Md. was to be merged into Subsidiary, which would be newly formed for the purpose. Subsidiary would acquire the property of Webster-Md., giving to the Webster-Md. stock-

4. 26 U.S.C. §368(a)(1)(A) provides:

"(a) Reorganization.—

"(1) In general. — For purposes of parts I and II and this part, the term 'reorganization' means—

"(A) a statutory merger or consolidation. . . ."

26 U.S.C. §368(a)(2)(D) provides:

"(a) Reorganization.—

* * *

"(2) Special rules relating to paragraph (1).—

* * *

"(D) Statutory merger using stock of controlling corporation. — The acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as 'controlling corporation') which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction under paragraph (1)(A) if (i) such transaction would have qualified under paragraph (1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction."

holders shares of Beck stock in exchange for their Webster-Md. stock.

The transaction was set forth in two documents, both dated May 6, 1969: (1) the Plan and Agreement of Reorganization (hereinafter "Plan & Agreement") which was entered into by Webster-Md., its stockholders, Beck, and Subsidiary;[5] and (2) the "Articles and Agreement of Merger" (hereinafter "Merger and Agreement") which was entered into between Subsidiary and Webster-Md.

Under the terms of these documents, Webster-Md. was to be merged into Subsidiary, which would become the surviving corporation. The Webster-Md. stockholders would receive approximately $2.5 million worth of Beck stock, or 84,388 shares, in immediate payment for their Webster-Md. stock. In the event that on December 31, 1971, the market value of 84,388 shares of Beck stock should be less than 150% of its market value on May 6, 1969, then, according to an "Adjustment of Consideration" (set forth in the Plan & Agreement), Subsidiary would make a deferred payment to Webster-Md.'s former stockholders by delivering to them sufficient additional shares of Beck stock to increase the total value of Beck shares held by them to 150% of the value of such shares on May 6, 1969.

5. During the negotiations Subsidiary was named "Beck-Webster Inc." Upon consummation of the merger the name was changed to "Webster-Clothes Inc." In order to avoid confusion on the part of the reader we have labelled the Delaware subsidiary "Subsidiary" throughout rather than initially call it by one name, then denominate it by another.

The Plan & Agreement sets forth a series of obligations and warranties that extend from both Beck and Subsidiary to Webster-Md. and to the latter's stockholders. In Paragraph 3(f) Beck undertook, should the provisions of the "Adjustment of Consideration" be invoked, to apply to the American Stock Exchange ("AMEX") for the listing of additional shares and covenanted to "take such steps as may be necessary to maintain the existence and solvency of Beck Subsidiary." In Paragraph 6 of the Plan & Agreement Beck and Subsidiary make a series of parallel representations and warranties. For instance, Paragraph 11(e) provided: "BECK and BECK Subsidiary hereby agree to indemnify and hold harmless the stockholders against and in respect of any and all damage, deficiency, loss, claims, demands, actions, suits, proceedings, judgments and assessments... resulting from any misrepresentations, breach of warranty or nonfulfillment of any agreement, obligation or covenant to be performed by Beck or Beck Subsidiary...." (emphasis added). Correspondingly, Beck and Subsidiary received in Paragraphs 11(a-d) certain assurances and remedies from Webster-Md. and its stockholders.

On July 10, 1970, the American Stock Exchange suspended trading in Beck Common Stock and thereafter its shares were traded only in the Over-the-Counter market. On May 27, 1971, Beck filed a petition for reorganization under Chapter X of the Bankruptcy Act, which was approved by order of the district court on that date. In addition to the appointment of the Trustees and the delineation of their powers and duties the order

restrained all persons from interfering with the Bankruptcy Court's exclusive jurisdiction over the debtor and its property.[6]

Needless to say, on December 31, 1971, the 84,388 Beck shares received by Webster-Md.'s former stockholders were not worth 150% of their value on May 6, 1969, and because of the Chapter X proceeding Beck was unable to comply with the "Adjustment of Consideration" as set forth in the Plan & Agreement.

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6. The Order provided in pertinent part that all persons are:

> "enjoined and stayed from commencing or continuing any action at law or suit or proceeding in equity against said debtor or said trustees in any court, or from executing or issuing or causing the execution or issuance out of any Court of any writ, process, summons, attachment, subpoena, replevin, execution or other process for the purpose of impounding or taking possession of or interfering with or enforcing a lien upon any property owned by or in the possession of the said debtor or said Trustees, and from doing any act or thing whatsoever to interfere with the possession or management by said debtor or said Trustees of the property and assets of the within estate, or in any way interfere with said trustees in the discharge of their duties herein, or to interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over said debtor and said trustees and their respective properties. . . ."

On January 13, 1972, Jack Feldman, et al.,[7] the appellants (hereinafter "the Feldmans"), who, as the former owners of about 65% of the Webster-Md. shares, were participants in the merger, instituted an action in the Circuit Court of Baltimore City, Baltimore, Maryland, against Subsidiary by filing a Bill of Complaint which sought, among other things, to cancel and rescind the Merger Agreement. Neither Beck nor its Trustees were named as defendants. In Count 1 of the Bill, the Feldmans claimed that the inability of Subsidiary to deliver additional shares of Beck stock having the value required by the "Adjustment of Consideration" provisions of the Plan & Agreement

> "constitute[d] a total failure of the consideration promised to Plaintiffs [the Feldmans] by the Defendant in exchange for the delivery by the Plaintiffs of all their stock in Webster-Md. to the Defendant and in consideration for Plaintiffs' actions which caused Webster-Md. to agree to the merger of Webster-Md. into the Defendant."

7. "Jack Feldman, Nancy I. Feldman Gimbel; Abraham Feldman; Lena Feldman; Julius Feldman; Selma Feldman; Helen W. Feldman; Abraham Feldman and Edward E. Obstler, Personal Representatives for Louis S. Feldman, deceased; Doris Feldman Hyatt; Leba Ann Feldman Rotker; Florence L. Kobernick; Linda D. Duritz; Rose Feldman; Norma Feldman Schrago; Bernice Elain Suser; Stephen Suser; Abraham Feldman, Trustee of Nancy Ilene Feldman Gimbel; Jack Feldman, Trustee under the Will of Edward Feldman; Mercantile Safe Deposit & Trust Co., Trustee of Suzanne Louise Feldman; Mercantile Safe Deposit & Trust Co., Trustee of Nancy Ilene Feldman Gimbel; and Mercantile Safe Deposit & Trust Co., Trustee under Will of Edward Feldman."

The prayer for relief sought the cancellation and rescission of the Merger Agreement, the return to the Feldmans of the shares necessary to restore them to their prior percentage of equity in Webster Clothes (65%) and an accounting.

Under Paragraph 11(e) of the Plan & Agreement, Count II sought indemnification by Subsidiary for damages and losses "resulting from the breach or non-fulfillment of any agreements, obligations or covenant to be performed by Beck under the Plan & Agreement or Merger Agreement" including the pro-rata share of $2.7 million. In Count III, essentially the same relief was sought, this time based on Subsidiary's breach of its own covenants under Paragraph 11(e). Count IV sought damages in the sum of $2,425,746.63.

The Baltimore Circuit Court, upon the Feldman's ex parte motion, issued an order enjoining Subsidiary, "its officers, agents, servants, employees, and attorneys, and all other persons in active concert and participation with it from doing any of..." an enumerated list of acts which might facilitate the depletion of Subsidiary's assets by Beck. Neither the Bill of Complaint nor the ex parte petition for injunctive relief named Beck as a defendant.

The instant action arose from the Trustees' attempt to enjoin the Maryland proceedings. Although the Maryland proceedings failed to name Beck as a defendant and were directed against Subsidiary, the Trustees of Beck, on January 21, 1972, claiming a violation of the Chapter X pro-

tective order[8] prayed for an order to show cause why the Feldmans "should not be enjoined from taking any further steps or actions in the Maryland proceedings and why they should not be restrained from in any other manner interfering with the possession or management by the Trustees of the estate...." On the same date Judge Cannella signed the order to show cause containing a provision staying until his hearing of the issue any further steps in the Maryland proceedings and ordering the respondents (the Feldmans) to vacate the ex parte Maryland order. By stipulation filed on January 25, 1972, the Feldmans agreed to vacate the Maryland ex parte order and the Trustees agreed to refrain from entering into any unusual transactions with Subsidiary.

In a decision dated April 19, 1972, Referee Herzog granted the motion to restrain further proceedings in the Maryland action. Conceding the validity of the general rule "that Section 116(4) does not authorize the Chapter X court to enjoin prosecution of a suit against a wholly independent subsidiary..." the Referee found that the "equities demanded departure from the general rule" because Subsidiary is "an independent entity by virtue of the sheerest-fiction" and "was a mere adjunct or instrumentality" of Beck, and as such, the corporate veil which separated Beck and Subsidiary should be pierced, at least with regard to the instant transaction with the Feldmans. By so doing, the Bankruptcy Court, exercising its

8. See footnote 6 supra and accompanying text.

jurisdiction under §§511 and 516(4), was able to reach the Maryland action.

On September 26, 1972, Judge Cannella, essentially approving Referee Herzog's reasoning, affirmed the order and pierced the corporate veil. The question before us is whether the Bankruptcy Court had jurisdiction to enter the injunction.

THE LAW

Under 11 U.S.C.§511 the Bankruptcy Court in Chapter X proceedings has "exclusive jurisdiction of the debtor and its property, wherever located." Section 516(4) provides in pertinent part that the court may "enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor" (emphasis added). In determining whether Subsidiary or its assets constitute "property" of the debtor within the meaning of the Act, we must note that Beck's sole interest in Subsidiary is its ownership of Subsidiary's outstanding stock. Ownership of all of the outstanding stock of a corporation, however, is not the equivalent of ownership of the subsidiary's property or assets. See In Re Adolf Gobel, Inc., 80 F.2d 849, 851 (2d Cir. 1936); Klein v. Board of Tax Supervisors, 282 U.S. 19, 23-24 (1930); Liman v. Midland Bank Ltd., 309 F. Supp. 163, 167 (S.D.N.Y. 1970). Even though the value of the subsidiary's outstanding shares owned by the debtor may be directly affected by the subsidiary's disputes with third

parties, "Congress did not give the Bankruptcy Court exclusive jurisdiction over all controversies that in some way affect the debtor's estate." Callaway v. Benton, 336 U.S. 132, 142 (1949).

Consistent with this approach is the general rule—upon which the parties, the Referee and the District Judge agree--that §516(4) of the Bankruptcy Act does not authorize the Chapter X court to enjoin a suit against a solvent independent subsidiary of the debtor merely because its stock is held by the debtor in reorganization. See In Re Adolf Gobel, Inc., supra; In Re South Jersey Land Corp., 361 F.2d 610 (3d Cir. 1966); 6 Collier on Bankruptcy, Par.3.11 at 501; cf. Greenbaum v. Lehrenkrauss Corp., 73 F.2d 285 (2d Cir. 1934) (equity receiver of parent could not enjoin a suit against the subsidiary).

The foregoing general rule was established as the law of this Circuit in the leading case of In Re Adolf Gobel, Inc., supra, where we reversed a district court order which had enjoined certain state court proceedings directed at the debtor's subsidiary. Adolf Gobel, Inc., the debtor in the bankruptcy proceedings, had voted the common stock of its subsidiary, Decker & Sons, in favor of a sale of Decker's assets to Armour & Co. The appellant therein, which had leased certain equipment to Decker, sought to compel Decker to establish a fund to pay-off the lease (which Armour had refused to assume) and later sought damages for breach of the lease. We found that the Bankruptcy Court had no jurisdiction to restrain the action against Decker, stating "it is

plain that the suit was not against this debtor nor was it a judicial proceeding to enforce any lien upon its estate. The assets of the Decker corporation were involved— not the Decker stock— which was part of the debtor's estate.... But mere financial interest of a bankrupt estate in the outcome of the litigation pending in state courts does not authorize the issuance of an injunction against such prosecution." 80 F.2d at 852. Gobel was followed as recently as 1966 in In Re South Jersey Land Corp., supra, and no basis is offered for rejecting its reasoning, which is not seriously questioned. In Re Federal Biscuit Co., 203 F.37 (2d Cir. 1913), and In Re Collier, 4 F. Supp. 700 (S.D.N.Y. 1933), which are relied upon by the debtor, are clearly distinguishable. There the third party's enforcement of its rights would, unlike the situation here, result in seizure and sale of property owned by the debtor, which had been deposited by it to secure a surety bond.

Absent a showing by the Trustees that Subsidiary was a mere sham or alter ego of Beck, the present case is governed by Gobel, since the Maryland suit herein is directed solely against Subsidiary and not against any property of the debtor (Beck). If rescission were granted in the Maryland action, Subsidiary would be ordered to return to Webster-Md. the assets which Subsidiary had obtained from Webster-Md. as a result of the merger and to return to the former Webster-Md. stockholders the Webster-Md. shares which Subsidiary had received from them in exchange for the 84,388 Beck shares transferred by it to them. In return Subsidiary would receive

back the 84,388 shares of Beck stock, which concededly are worth very little. Beck would still own the stock of Subsidiary, but the assets of Subsidiary would be worth much less. If, rather than rescission, damages were granted, Beck would still own the stock of Subsidiary, but the value of Subsidiary would be reduced by a sum approximating the amount of the damages. In either event Beck would not be deprived of its property, i.e., Subsidiary's outstanding shares. Admittedly there is no attempt by the Maryland plaintiffs to impress a lien upon the shares of Subsidiary owned by its parent-debtor (Beck) or to obtain relief against the debtor. The sole effect of a judgment against Subsidiary, therefore, would be to lower the value of Subsidiary's outstanding shares.[9] Thus, under traditional reasoning the dispute between appellants and Subsidiary is a controversy which might affect the worth of the debtor's estate, see Callaway v. Benton, supra, but not title to its "property."

In short, absent proof that Subsidiary was a mere sham or conduit rather than a viable entity, the Maryland suit is not a "proceeding to enforce a lien upon the property of the debtor" as that phrase is used in §516 of the Bankruptcy Act and the Bankruptcy Court therefore lacks jurisdiction. Apparently accepting the view that under the general rule the district court would not have the power to issue injunctive relief at the instance of the parent debtor with respect to its Subsidiary's dealings with third persons, the Trustees of the

9. We express no view on the merits of the Maryland proceedings, which of course are not before us.

debtor argue, and Referee Herzog and Judge Cannella agreed, that Subsidiary's separate corporate existence should be treated as a sham or mere formal technicality permitting the court to pierce the corporate veil and treat Subsidiary's property as that of the parent-debtor (Beck), at least for the purpose of restraining appellants' Maryland suit. In their view Subsidiary is not a distinct and separate entity from Beck but merely its instrumentality, newly created solely as a means of consummating the merger in a way that would benefit the stockholders of Webster-Md. but not with a view to conferring any benefit on Beck. Upon this assumption the Bankruptcy Court swept aside the corporate veil in the interest of getting to what it believed to be the substance of the transaction and of the resulting relationship of the parties.

Were we to accept the factual premises underlying the decisions of the Referee and of the district court, we would have no difficulty agreeing with their conclusion. It must be conceded that the general rule against enjoining a suit against a solvent subsidiary of the debtor is not inflexible, see 6 Collier on Bankruptcy Par. 3.11 at 500 (14th ed. 1972) and that the meaning of the term "property" turns on the particular facts of each case, see In Re South Jersey Land Corp., supra, 361 F.2d at 613, which may in some instances permit piercing of the corporate veil. However, where a debtor seeks to pierce that veil on the ground that its subsidiary is a mere dummy or alter ego, the burden of proof is on the debtor. Upon the record before us the Trustees failed completely to sustain that burden.

On the contrary, it is apparent that Subsidiary was formed for the mutual benefit of the parties and that thereafter, far from being a "mere instrumentality" of Beck, it operated as a viable, independent going commercial concern.

While Subsidiary may have been a mere shell when, immediately prior to the merger, it was formed and the transaction was structured to conform to the hybrid "Type A" form of corporate reorganization, Internal Revenue Code, 26 U.S.C. §§368(a)(1)(A) and 368(a)(2)(D), the proof is clear and undisputed that ever since the merger it has functioned as a self-sustaining enterprise, which conducts the going business of Webster Clothes, Inc. Since the merger Subsidiary, furthermore, has operated that business in substantially the same manner as it had been operated prior to the merger. It has traded under its own name (Webster Clothes, Inc.), has had its own separate assets, creditors and obligations, and has consistently held itself out to the general public and trade creditors as a busines separate and distinct from Beck. In Maryland it has assets customarily associated with active clothing concerns, including leasehold interests in retail stores, its clothing factory, fixtures, equipment, inventory and bank accounts. There has been no commingling of assets between Beck and Subsidiary. There is no evidence that Subsidiary has had grossly inadequate capital, that the debtor-parent pays its debts, or that its sources of business is dependent in any way upon that of its parent. Nor is there any indication that in the conduct of its affairs since the merger Subsidiary's separate and independent corporate entity has been disregarded.

Thus, at least subsequent to the merger, it is hardly open to dispute that Subsidiary has been a vital and viable independent entity. We cannot accept or agree with the Referee's characterization of Subsidiary as a "devious ... legal rigamarole," and "independent entity by the sheerest fiction," and an "adjunct or instrumentality of the parent, Beck." These conclusions, being unsupported by the record, are clearly erroneous. On the contrary, the record reveals a carefully constructed commercial transaction in which parties of relatively equal bargaining strength, represented by able counsel, negotiated and bargained for a distinct operating subsidiary that was to conduct its own independent business.

Both the Plan & Agreement and the Merger Agreement carefully delineated a transaction through which the business of Webster Clothes would continue to be carried on by Subsidiary as a separate bona fide operating entity. Moreover, Subsidiary and Webster-Md. bargained for and received from each other reciprocal rights and assurances, distinct from Beck's rights and obligations. Paragraph 11(e), supra, of the Plan & Agreement provided that "Beck and Beck Subsidiary" (emphasis added) would each separately indemnify and hold harmless the Webster-Md. stockholders against losses, damage and the like. Correspondingly, the representations made by the stockholders were for the benefit of both Beck and Beck Subsidiary. See, e.g., Paragraph 11(d) of Plan & Agreement.

The background of the parties' creation of separate and distinct obligations is clear. Beck did not want to pay immediately the full agreed-upon price, which would require transfer at once of Beck shares worth approximately $3.75 million for Webster-Md.'s outstanding shares. Instead it wanted to exchange Beck shares worth approximately two-thirds of the price at the time of the merger, i.e., $2.5 million, and defer payment of the balance until December 31, 1971, in the hope that by that time the value of the Beck shares might appreciate to $3.75 million, which would render unnecessary transfer of additional Beck shares. The Webster-Md. stockholders, on the other hand, wanted to be assured that if no such appreciation in value of the Beck shares should occur they would receive from Subsidiary, to which Webster-Md.'s assets would in the meantime have been transferred, the balance of the purchase price. It was part of this arrangement that Subsidiary, which would have acquired Webster-Md.'s assets, be maintained as a separate operating entity rather than have its assets exposed to Beck's liabilities by having Beck acquire them directly.

Nor are we persuaded that the equities, as between the debtor and the Webster-Md. stockholders, weigh in favor of disregarding Subsidiary's separate corporate existence. It is true that one of the reasons for the organization of Subsidiary as a distinct entity was to shape the contours of the transaction to conform to Internal Revenue Code, §§368(a)(1)(A) and 368(a)(2)(D), so that the Webster-Md. stockholders could defer recognition for tax purposes of the gain, with the Beck shares received by them having the same tax basis as the

Webster-Md. shares exchanged by them. See 26 U.S.C. §§354(a)(1) and 358(a)(1). At the same time the Webster-Md. stockholders minimized the risk of their not receiving any deferred payment to which they might become entitled on December 31, 1971, by obtaining Subsidiary's independent covenant to exchange any additional Beck shares that might come due under the provisions for "Adjustment of Consideration," and by transferring the Webster-Md. assets to Subsidiary rather than permitting them to be commingled with Beck's property.

But Beck also stood to gain substantial benefits from the organization of Subsidiary and from the tripartite form of the transaction. A direct merger of Webster-Md. into Beck would have obligated Beck to assume all of the obligations and debts of the clothing firm. The interposition of Subsidiary, on the other hand, provided Beck with a measure of insulation from such liability. Where a parent corporation desires the legal benefits to be derived from organization of a subsidiary that will function separately and autonomously in the conduct of its own distinct business, the parent must accept the legal consequences, including its inability later to treat the subsidiary as its alter ego because of certain advantages that might thereby be gained. In short the parent cannot "have it both ways." The words of the Supreme Court in Schenley Distillers Corp. v. United States, 326 U.S. 432, 437 (1946), although stated in another context, are appropriate:

> "While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages...."

Also, by employing this three-party transaction, Beck might have been able to treat the acquisition, for accounting purposes, as a "pooling of interests" rather than as a purchase. See ARB No.48 (Jan. 1957) printed in 2 APB Accounting Principles 6081 (1969), amended by APB Opinion No. 16 (Aug. 1970). As such "some of the current costs of the assets, including goodwill" might not be reflected on the books of the acquiring corporation. See APB Opinion No.16, Par.35 (Aug. 1970). Finally, the form of the transaction may well have obviated the necessity of Beck's obtaining approval of the merger by its own shareholders, thereby avoiding the delay, cost and effort involved in preparing and distributing a proxy statement and of obtaining the percentage of stockholder approval required by Delaware law.

Thus, although Subsidiary was a child of the merger, it was conceived and created by the two parties as a viable operating entity pursuant to a perfectly legitimate business arrangement from which each mutually derived benefits. Under the circumstances it was error to conclude that the

equities justified piercing of the corporate veil.[10] Indeed to deny the Webster-Md. stockholders the right to enforce the separate independent covenants for which they, like other creditors of Subsidiary, lawfully bargained[11] would be inequitable.

Finally, the Trustees contend that restraint of the Maryland suit will facilitate their administration of the debtor's estate, already a complicated task, since they will otherwise be forced to divert their energies to defense of that suit in an inconvenient forum in order to preserve the value of the debtor's

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10. The cases relied on by Beck are all distinguishable and at most stand for the proposition that the general rule is flexible, and that the corporate form will be pierced when the equities so require. For example, in Hamilton Ridge Lumber Sales Corp. v. Wilson, 25 F.2d 592 (4th Cir. 1928), a lumber manufacturing company, which was in financial difficulty, and a bank to which it was indebted, organized a sham sales corporation for the sole purpose of securing the lumber company's debt to the bank. The sales company "purchased" lumber in return for notes which were then discounted by the bank. The sales corporation never had actual possession of the lumber, had been organized solely for this one transaction, and never transacted any other business. The court, ignoring the separate corporate entities, properly found that there had been neither a valid sale nor pledge and that the transaction "was not bona fide to the extent that there was a real sale of the lumber in question. The Sales Corporation had no real business existence, had in fact no organization by which it could transact business...." 25 F.2d at 594. The situation in the present case is entirely different. Subsidiary, unlike the sales corporation in Hamilton Ridge, is a bona fide going commercial concern.

The Trustees do not argue that other creditors of Subsidiary should be deprived of their right to enforce their claims separately against Subsidiary.

stock interest in Subsidiary. In our view this argument puts the cart before the horse. The corporate veil cannot be disregarded merely because it would make for "an efficient and economical administration" of the debtor's estate, Greenbaum v. Lehrenkrauss, 73 F.2d 285, 287 (2d Cir. 1934). As we stated in In Re Gobel, supra: "Though facility in reorganization is desirable, it is not the sole consideration." 80 F.2d at 853. We have found that piercing the corporate veil here is not warranted. If it is desirable for the Bankruptcy Court to have jurisdiction of all litigation involving subsidiaries, solvent or not, of the debtor, the answer lies with Congress.

The order restraining the Maryland court action is reversed.

Statutes Cited

17 C.F.R. 230.133

§230.133 Definition for purposes of section 5 of the act, of "sale," "offer," "offer to sell," and "offer for sale."

(a) For purposes only of section 5 of the Act, no "sale," "offer to sell," or "offer for sale" shall be deemed to be involved so far as the stockholders of a corporation are concerned where, pursuant to statutory provisions in the state of incorporation or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a plan or agreement for a statutory merger or consolidation or reclassification of securities, or a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person or securities of a corporation which owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such person, under such circumstances that the vote of a required favorable majority (1) will operate to authorize the proposed transaction as far as concerns the corporation whose stockholders are voting (except for the taking of action by the directors of the corporation involved and for compliance with such statutory provisions as the filing of the plan or agreement with the appropriate State authority), and (2) will bind all stockholders of such corporation except to the extent that dissenting shareholders may be entitled, under statutory provisions or provisions

contained in the certificate of incorporation, to receive the appraised or fair value of their holdings.

(b) Any person who purchases securities of the issuer from security holders of a constituent corporation with a view to, or offers or sells such securities for such security holders in connection with, a distribution thereof pursuant to any contract or arrangement, made in connection with any transaction specified in paragraph (a) of this section, with the issuer or with any affiliate of the issuer, or with any person who in connection with such transaction is acting as an underwriter of such securities, shall be deemed to an underwriter of such securities within the meaning of section 2(11) of the Act. This paragraph does not refer to arrangements limited to provision for the matching and combination of fractional interests in securities into whole interests, or the purchase and sale of such fractional interests, among security holders of the constituent corporation and to the sale on behalf of, and as agent for, such security holders of such number of fractional or whole interests as may be necessary to adjust for any remaining fractional interests after such matching.

(c) Any constituent corporation, or any person who is an affiliate of a constituent corporation at the time any transaction specified in paragraph (a) of this section, is submitted to a vote of the stockholders of such corporation, who acquires securities of the issuer in connection with such transaction with a view to the distribution thereof

shall be deemed to be an underwriter of such securities within the meaning of section 2(11) of the Act. A transfer by a constituent corporation to its security holders of securities of the issuer upon a complete or partial liquidation shall not be deemed a distribution for the purpose of this paragraph.

(d) Notwithstanding the provisions of paragraph (c) of this section, a person specified therein shall not be deemed to be an underwriter nor to be engaged in a distribution with respect to securities acquired in any transaction specified in paragraph (a) of this section, which are sold by him in brokers' transactions within the meaning of section 4(4) of the Act, in accordance with the conditions and subject to the limitations specified in paragraph (e) of this section, if such person—

(1) Does not directly or indirectly solicit or arrange for the solicitation of orders to buy in anticipation of or in connection with such brokers' transactions;

(2) Makes no payment in connection with the execution of such brokers' transactions to any person other than the broker; and

(3) Limits such brokers' transactions to a sale or series of sales which, together with all other sales of securities of the same class by such person or on his behalf within the preceding six months, will not exceed the following:

(i) If the security traded only otherwise than on a securities exchange, approximately one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions, or

(ii) If the security is admitted to trading on a securities exchange, the lesser of approximately (a) one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (b) the largest aggregate reported volume of trading on securities exchanges during any one week within the four calendar weeks preceding the receipt of such order.

(e) For the purposes of paragraph (d) of this section:

(1) The term "brokers' transactions" in section 4(4) of the Act shall be deemed to include transactions by a broker acting as agent for the account of the seller where (i) the broker performs no more than the usual and customary broker's functions, (ii) the broker does no more than execute an order or orders to sell as a broker and receives no more than the usual or customary broker's commissions, (iii) the broker does not solicit or arrange for the solicitation of orders to buy in anticipation of or in connection with such transactions and (iv) the broker is not aware of any circumstances indicating that his principal is failing to comply with the provisions of paragraph (d) of this section;

(2) The term "solicitation of such orders" in section 4(4) of the Act shall be deemed to include the solicitation of an order to buy a security, but shall not be deemed to include the solicitation of an order to sell a security;

(3) Where within the previous 60 days a dealer has made a written bid for a security or a written solicitation of an offer to sell such security, the term "solicitation" in section 4(4) shall not be deemed to include an inquiry regarding the dealer's bid or solicitation.

(f) For the purpose of this rule, the term "constituent corporation" means any corporation, other than the issuer, which is a party to any transaction specified in paragraph (a) of this section. The term "affiliate" means a person controlling, controlled by or under common control with a specified person.

(Sec. 5, 48 Stat. 77; 15 U.S.C. 77e) [19 F.R. 7129, Nov. 3, 1954, as amended at 24 F.R. 5900, July 23, 1959; 30 F.R. 2022, Feb. 13, 1965; 33 F.R. 566, Jan. 17, 1968].

Judgment of United States Court of Appeals for the Second Circuit

(Filed April 30, 1973)

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeal for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirtieth day of April, one thousand nine hundred and seventy-three.

Present: HON. J. JOSEPH SMITH
HON. WILFRED FEINBERG

HON. WALTER R. MANSFIELD

Circuit Judges,

In the Matter of

Beck Industries, Inc., formerly known as A.S. Beck Shoe Corporation,

Debtor,

Jack Feldman; Nancy I. Feldman Gimbel; Abraham Feldman; Lena Feldman; Julius Feldman; Selma Feldman; Helen W. Feldman; Abraham Feldman; and Edward E. Obstler as personal representatives for

Judgment

Louis S. Feldman, deceased; Leba Ann Feldman Rotker; Florence L. Kobernick; Linda D. Duritz; Rose Feldman; Norma Feldman Schrago; Bernice Elaine Suser; Stephen A. Suser; Mercantile Safe Deposit & Trust Co., Guardian for Suzanne Louise Feldman; Mercantile Safe Deposit & Trust Co., and Abraham Feldman, Trustees of Suzanne Louise Feldman; Mercantile Safe Deposit & Trust Co. and Abraham Feldman, Trustees of Nancy Ilene Feldman Gimbel; and Mercantile Safe Deposit & Trust Co. and Jack Feldman, Trustees under Will of Edward Feldman,

Appellants.

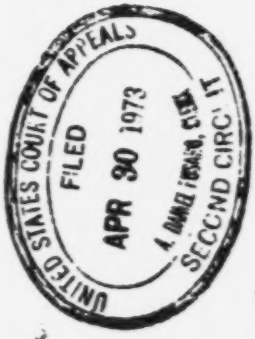
Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed in accordance with the opinion of this court with costs to be taxed against the appellees.

s/ A. Daniel Fusaro,
Clerk

Judgment


UNITED STATES COURT OF APPEALS
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